

FY 2016 Market Dominant Product Incremental Costs

I. PREFACE**A. Purpose and Content**

USPS-FY16-43 is provided as an initial step toward eventual compliance with Docket No. RM2016-13, Order No. 3641 (December 1, 2016). USPS-FY16-43 provides incremental costs for market dominant products and classes for FY 2016, along with supporting documentation. Also provided, in this preface, are these incremental costs with final adjustments applied and the associated revenues and the resulting incremental cost coverages (final adjustments included). Also displayed are group incremental costs (with final adjustments included) for four of the six competitive product groups for which volume variable and product specific costs are shown in the Public CRA (USPS-FY16-1). These competitive product costs, however, are developed in USPS-FY16NP10, and merely reproduced here as results.

B. Predecessor Document

There is no direct predecessor for this folder. In prior ACR dockets, materials regarding incremental costs for competitive products appeared in folder NP10 (e.g., in Docket No. ACR2015, USPS-FY15-NP10). Prior materials on incremental costs have been filed in rate cases, most recently the testimony of witness Pifer (USPS-T-18) in Docket No. R2006-1.

C. Corresponding Nonpublic Document

The corresponding nonpublic document, presenting incremental cost materials for competitive products, is USPS-FY16-NP10.

D. Methodology

For the most part, USPS-FY16-43 applies essentially the same basic methodology as applied with respect to competitive products in the FY 2015 ACR in USPS-FY15-NP10. As the Commission noted, the model used in USPS-FY15-NP10, with modification, can provide the approved methodology to calculate class-level and product-level incremental costs.¹ The model from USPS-FY15-NP10 has been modified to produce the class-level and product-level incremental costs for this folder.

The USPS-FY15-NP10 methodology was developed in Proposal 22, Docket No. RM2010-4 (approved by the Commission in Order No. 399). As indicated in Proposal 22, the calculation of incremental costs, including any group specific

¹ Docket No. RM2016-2, Order No. 3506 (September 9, 2016) at page 60.

costs, is based on the methodology presented by witness Bradley and implemented by witness Kay in Docket No. R2000-1.² The methodology was successfully implemented in subsequent rate cases, such as Docket No. R2001-1 and Docket No. R2005-1.³

As indicated in Proposal 22, this model cannot be applied to all products costs, but rather is applied to domestic products only, due to the inability to obtain ICRA data in the needed format.⁴ Consistent with the current limitations identified in Proposal 22, the FY 2016 incremental costs for each international market dominant product would simply be the sum of the volume variable costs and the product specific costs for that product. Since the public portion of those international costs are already shown in the public CRA in USPS-FY16-1, they are not reproduced here.

The available incremental cost information regarding Market Dominant products is summarized in the Excel file **IC2016Public.ICSummaryRpt.xls**, and is also reproduced at the end of this Preface.⁵ The results start with a column (Column 4) showing the product-level and class-level incremental costs generated by the existing model. By necessity, however, this model uses as inputs volume-variable costs *before* any final adjustments. Therefore, additional columns are

² See, Direct Testimony of Michael D. Bradley on Behalf of the United States Postal Service, Docket No. R2000-1, USPS-T-22; and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2000-1, USPS-T-23.

³ See Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2001-1, USPS-T-21 and Direct Testimony of Nancy R. Kay on Behalf the United States Postal Service, Docket No. R2005-1, USPS-T-18.

⁴ The structure of the ICRA does not facilitate the calculation of incremental costs because the split of international products into market dominant and competitive is not done at the cost pool level. As a result, the ICRA costs for market dominant and competitive products by component are not available with the present ICRA model.

⁵ Incremental costs are presented in some rows containing multiple products (e.g., Total Single-Piece Letters and Cards, Total First-Class). As postal witnesses have repeatedly stressed (see, e.g., the Direct Testimony of Nancy R. Kay, USPS-T-21, Docket No. R2001-1, at page 20), the incremental costs of a group of products will be different from the sum of the incremental costs of the individual products within the group. As she explains in that testimony, this occurs because of how the total amount of the cost driver associated with the volume of the entire group is removed when calculating the aggregate group incremental costs. Readers therefore should not expect that the *incremental* costs shown in rows in this folder presenting results for multiple products will equal the sum of the *incremental* costs shown in the rows for the constituent products aggregated in that row.

presented showing the final adjustments, and then adding those final adjustments to the model-based incremental costs. Finally, revenues are shown, and incremental cost coverages are calculated using incremental costs after the final adjustments added. It may be noted, however, that final adjustments are adjustments to volume variable costs, and as such, technically speaking, are generally not directly applicable to incremental costs. However, the comparison of revenues and incremental costs without any consideration of final adjustments would be wholly inadequate in light of the important product cost information embedded in final adjustments. Therefore, moving beyond the established incremental costs models to take account of final adjustments was deemed necessary to make the available incremental cost information as comparable as possible to this year's CRA Report.

E. Input/Output

The inputs for the primary calculation of the incremental costs for domestic products are from the FY 2016 CRA Model (Model Files, Cost Matrices, and Reports), USPS-FY16-31, and FY 2016 CRA "B" Workpapers, USPS-FY16-32.

II. ORGANIZATION

The Incremental Cost (IC) Model is filed as USPS-FY16-43.zip. The zip file contains three folders with the files needed to use the IC Model:

- Documentation – Reference Files
- Programs – Program Files
- Model – Input and Output Files

The Documentation folder contains two files. The files in this folder and their functions are as follows:

- ICRunInstructions.doc – Instructional Document
- CostPoolsFY2016.xls – Input Cost Pool Data (added to FY2016.OutputMatrix.xls)

The Programs folder contains the two program files:

- IC.Model.xls – IC Model run module
- IC.DIM.xls – IC Model data input module

The Model folder contains three input files needed to replicate Domestic Competitive Incremental Cost:

- FY16Public.OutputMatrix.xls – Fiscal Year 2016 output matrix
- IC2016Public.cntl.xls – Incremental Cost 2016 control tables

- IC2016Public.PS.xls – Incremental Cost 2016 product specific

The Model folder also contains five output files that are a result of the model's run:

- IC2016Public.CRpt.xls – IC C (Cost Segments and Components) Report
- IC2016Public.ICSummaryRpt.xls – IC Summary Report
- IC2016Public.PSRpt.xls – Group Product Specific Report
- IC2016Public.CP.xls – Cost Pool calculation workbook
- IC2016Public.IC.xls – IC calculation workbook

Component Name		Vol Var / Prod Spec Cost	Group Product Specific	Inframarginal	Incremental Cost	Final Adjustments	Incremental Cost with Final Adjustments	Revenue	Coverage
Source/Notes		USPS-FY16-31 C Report	USPS-FY16-NP10	Col.4 - (Col. 1 + Col. 2)		USPS-FY16-31 D Report	Col. 4 + Col. 5	USPS-FY16-42	Col. 7/ Col. 6
Columns		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
MARKET DOMINANT PRODUCTS									
First-Class Mail									
Single Piece Letters	3	5,321,700	0	180,564	5,502,264		5,502,264	9,458,402	172%
Single Piece Cards	4	232,080	0	750	232,831		232,831	282,150	121%
Total Single Piece Letters and Cards	5	5,553,780	0	203,247	5,757,027		5,757,027	9,740,552	169%
Presort Letters	8	4,404,127	0	65,213	4,469,340		4,469,340	14,839,781	332%
Presort Cards	9	172,761	0	129	172,890		172,890	576,737	334%
Total Presort Letters and Cards	10	4,576,888	0	71,759	4,648,648		4,648,648	15,416,517	332%
Flats	14	1,530,758	0	2,856	1,533,614		1,533,614	2,201,933	144%
Parcels	19	587,983	0	1,733	589,716		589,716	711,051	121%
Total First-Class	80	12,249,409	0	569,375	12,818,784		12,818,784	28,206,842	220%
Standard Mail									
High Density and Saturation Letters	21	517,752	0	2,747	520,499	-25,385	495,114	1,075,265	217%
High Density and Saturation Flats and Parcels	22	1,171,350	0	20,282	1,191,632	25,385	1,217,017	2,014,694	166%
Every Door Direct Mail Retail	24	54,055	0	84	54,139		54,139	145,650	269%
Carrier Route	23	1,331,279	0	3,865	1,335,144		1,335,144	1,827,176	137%
Letters	25	5,023,146	0	118,583	5,141,729		5,141,729	10,134,361	197%
Flats	26	2,984,593	0	14,004	2,998,597		2,998,597	2,376,772	79%
Parcels	27	83,272	0	8	83,281		83,281	53,126	64%
Total Standard Mail	81	11,165,447	0	648,650	11,814,097		11,814,097	17,675,066	150%
Periodicals									
In County	31	87,018	0	31	87,049		87,049	60,977	70%
Outside County	32	1,950,201	0	5,568	1,955,769		1,955,769	1,437,838	74%
Total Periodicals	82	2,037,219	0	6,247	2,043,466		2,043,466	1,506,713	74%
Package Services									
Alaska Bypass	45	19,714	0	0	19,714		19,714	33,523	170%
Bound Printed Matter Flats	42	130,558	0	28	130,586		130,586	208,585	160%
Bound Printed Matter Parcels	43	276,853	0	228	277,081		277,081	288,674	104%
Media and Library Mail	44	354,337	0	553	354,891		354,891	266,382	75%
Total Package Services	83	781,463	0	1,373	782,835		782,835	799,387	102%
U.S. Postal Service	85	318,123	0	37	318,161	-318,123		-	
Free Mail	86	37,068	0	4	37,071		37,071	-	
Special Services									
Ancillary Services									
Certified	51	521,116	0	4,620	525,737		525,737	670,497	128%
COD	52	4,941	0	0	4,941		4,941	2,029	41%
Insurance	54	42,845	0	1	42,846		42,846	76,946	180%
Registered Mail	55	16,251	0	1	16,252		16,252	31,637	195%
Stamped Envelopes	56	8,132	0	330	8,462	1,379	9,841	9,083	92%
Stamped Cards	57	253	0	0	253		253	605	239%
Other Ancillary Services	58	206,810	0	2,092	208,902		208,902	447,461	214%
Address Management Services	61	7,413	0	0	7,413	-621	6,792	16,734	246%
Caller Service	62	23,140	0	0	23,141		23,141	94,351	408%
Money Orders	73	116,707	0	54,979	171,686		171,686	156,371	91%
Post Office Box Service	74	603,916	0	16,480	620,396	-374,347	246,049	283,969	115%
Total Domestic Market Dominant Services	91	1,551,527	0	85,232	1,636,758	-367,581	1,269,177	1,789,692	141%

Note that on page 3 of the Public CRA in USPS-FY16-1, information is provided on the volume variable and product specific costs of six groups of Competitive Products. For two of those groups (Total Competitive International, Total Domestic Competitive Services), there is currently no incremental cost information available in USPS-FY16-NP10. Reproduced below, however, is group incremental cost information from USPS-FY16-NP10 for what is essentially each of the remaining four groups of Competitive Products for which data are shown in the Public CRA.

Component Name	Vol Var / Prod Spec Cost	Incremental Cost with Final Adjustments	Revenue	Coverage
Source/Notes	USPS-FY16-NP13	USPS-FY16-NP10	USPS-FY16-NP28	(Col. 3)/(Col. 2)
	C Report			
Columns	(1)	(2)	(3)	(4)
COMPETITIVE PRODUCT GROUPS				
Total Priority Mail Express	356,733	375,496	809,413	216%
Total First-Class Package Service	1,468,552	1,471,812	2,075,729	141%
Total Priority Mail	6,127,926	6,204,357	7,784,881	125%
Total Ground	2,840,367	3,089,194	5,191,580	168%